No. 766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

VIRGINIAN HOTEL CORPORATION OF LYNCHBURG,
Petitioner

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR PETITIONER

F. G. DAVIDSON, JR.
NOAH A. STANCLIFFE
THEODORE L. HARRISON
J. DONALD RAWLINGS
W. A. SUTHERLAND
Counsel for Petitioner

INDEX

CASES CITED

STATUTES

No. 766

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1942

VIRGINIAN HOTEL CORPORATION OF LYNCHBURG,
Petitioner

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR PETITIONER

Opinions Below

The opinion of the United States Board of Tax Appeals (now Tax Court of the United States), being a memorandum opinion, is not officially reported but is printed in the record (R. 34). The opinion of the United States Circuit Court of Appeals for the Fourth Circuit is reported in 132 F. (2d) 909 (R. 46).

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on January 2, 1943 (R. 53). The petition for certiorari was filed in this Court on February 25, 1943, and

certiorari was granted on April 5, 1943 (87 L. ed. adv. ops. 778). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938).

Question Presented

The sole question presented by this writ is whether petitioner, in determining the adjusted basis of its depreciable assets at December 31, 1937 upon which to compute its depreciation for the calendar year 1938, is required to subtract from the cost of such depreciable assets the amount by which the depreciation reported on its tax returns for the years 1931 to 1936 inclusive exceeded the depreciation properly allowable in those years, where petitioner sustained in each such year a net loss greater than such excess.

Statute Involved

The statute involved is the Revenue Act of 1938 (52 Stat. 447), Sections 23 (l) and 23(n), 113(b)(1)(B) and 114(a). These sections provide as follows:

"Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

* * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

* * * *

(n) *Basis for depreciation and depletion.*—The basis upon which depletion, exhaustion, wear and tear,

and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * *

Sec. 113. Adjusted Basis for Determining Gain or Loss.

* * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * *

Sec. 114. Basis for Depreciation and Depletion.

(a) *Basis for depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * *"

Statement

Petitioner, a Virginia corporation, from January 1, 1931, and its predecessor partnership from June 1, 1927 to December 31, 1930, operated a hotel in Lynchburg, Vir-

ginia (R. 23). The cost of its depreciable assets and the additions thereto are tabulated in the Record (R. 24). From June 1, 1927 through 1938 depreciation on such assets was reported by petitioner and the predecessor partnership on the returns on a straight line basis at a rate of 15% on carpets and 10% on all other equipment, which would have exhausted the properties in 6⅔ and 10 years, respectively (R. 25). This depreciation was excessive. The amounts properly allowable in those years was 8% on carpets and 5% on all other equipment based upon useful lives of 12½ and 20 years, respectively[1] (R. 25, 26). There was a profit for each of the years 1927 to 1930, inclusive, and for the year 1937; and the entire depreciation reported in each such profit year served to reduce taxable income. Petitioner sustained a loss in each year from 1931 to 1936 inclusive even if only the amounts of depreciation properly allowable in each such year had been deducted, so that the excessive depreciation reported on each such return did not reduce taxable income (R. 25).

The difference between the depreciation reported on the returns in said loss years and the depreciation properly allowable in such years is $31,400.25 (R. 26). In auditing petitioner's return for 1938 respondent adjusted the basis of petitioner's property by subtracting from the cost thereof, not only the depreciation properly allowable in such loss years, but also the amount of $31,400.25 in excess of that properly allowable in such loss years, and asserted a deficiency in tax resulting from such action (R. 14, 15, 25). Petitioner claims that the depreciation in excess of that "allowable" for each such loss year should not be subtracted from the cost of its properties in determining the adjusted basis thereof at December 31, 1937. Petitioner admits of course that the depreciation properly allowable

---

[1] For brevity we hereafter refer only to the items which had a 20 year life. The principle involved is of course exactly the same for the shorter lived property.

in each of such years is deductible, even though it did not reduce taxable income.[2]

The issue was tried before the Board on a stipulation of facts which are summarized above. On May 6, 1942 the Board filed its memorandum opinion holding in favor of petitioner and stating (R. 38):

> "The amount of $31,400.25, the excess of depreciation deductions taken in the years 1931 to 1936, inclusive, over the amounts allowable, should be added to the base [in other words, not subtracted from the cost] in computing the depreciation allowable for 1938."

On May 28, 1942 the Board entered its decision determining that petitioner overpaid its tax for 1938 in the sum

---

[2] The method employed in computing depreciation for 1938 upon petitioner's property, and the difference between the petitioner's and respondent's computations, may be made clear by a simple example. For instance, take additions to furniture and fixtures purchased in 1931 (R. 16, 19):

Petitioner's Computation		*Respondent's Computation*	
1. Cost of 1931 Additions.	$15,033.55	1. Cost of 1931 Additions	$15,033.55
2. Depreciation allowable (5%) for 1931-1936 and depreciation allowed (10%) for 1937........	5,918.57	2. Depreciation reported in petitioner's returns 1931-1937	9,771.83
3. Adjusted basis at beginning of 1938 (1-2).....	$ 9,114.98	3. Adjusted basis at beginning of 1938 (1-2)..	$ 5,261.72
4. Depreciation for 1938—adjusted basis divided by remaining life (13½ years)	675.18	4. Depreciation for 1938—adjusted basis divided by remaining life (13½ years)	389.76

It is to be noted that the only point at which petitioner and respondent differ in applying this method is with respect to item 2, the amount of depreciation to be deducted from cost in arriving at the adjusted basis at the end of 1937. Petitioner subtracts only the amount of depreciation properly "allowable" in the loss years. Respondent subtracts the amounts reported on petitioner's returns for such years, even though the excess over the amount allowable in each of the loss years was not a proper deduction in those years *and* did not reduce petitioner's taxable income.

of $13.47 (R. 39). This decision was reversed by the Circuit Court of Appeals, and that Court's decision is now here for review upon writ of certiorari (R. 53).

Specification of Errors to Be Urged

The Court below erred in holding:

1. That petitioner in computing the adjusted basis of its depreciable assets as of December 31, 1937 is required to subtract not only the depreciation "allowable" in prior years but also the depreciation reported on its returns in excess of that legally "allowable" and which did not reduce taxable income.

2. That the excessive depreciation reported in petitioner's returns for the years 1931 to 1936 inclusive has been "allowed" within the meaning of Section 113(b)(1)(B) of the Revenue Act of 1938, although it did not serve to reduce taxable income.

Summary of Argument

Section 113(b)(1)(B) of the Revenue Act of 1938, which requires that in determining the unexhausted basis of depreciable property adjustment be made for depreciation "to the extent allowed (but not less than that allowable)", does not require that there be subtracted from the cost of property depreciation in excess of that properly "allowable" in prior years where such excessive depreciation was reported on the taxpayer's returns for such prior years but did not reduce taxable income. Such excessive depreciation in loss years was not "allowed" within the meaning of the subsection.

It is clear from the legislative history of subsection (B), which was amended to its present form in 1932, that the

word "allowed" was added for the sole and declared purpose of requiring the reduction of basis by the amount of depreciation deducted on returns in excess of that "allowable" where, and only where, such excess resulted in reducing income and the government would be barred from collecting the taxes due for the prior years.

The ordinary usage of the word "allowed" embraces much more than the mere reporting of an item on a return.

Congress and the Commissioner have had a uniform policy of not seeking to bind a taxpayer by errors in prior years and of not perpetuating those errors in later years, except in those situations where a change in position will result in unfairly depriving the government of taxes to which it is entitled. Section 113(b)(1)(B), as petitioner construes it, clearly conforms with this policy; upon respondent's construction it is clearly out of harmony with this policy.

Petitioner's interpretation is confirmed by the fact that Congress, in enacting the Revenue Act of 1942 (56 Stat. 812), amended Section 113(b)(1) in a number of respects but did not change one word of subsection (B) involved herein—notwithstanding the fact that at that time four cases had been decided by various courts construing the word "allowed" as petitioner construes it, and that at that time no case had been decided which adopted respondent's construction.

The construction of the word "allowed" advanced by respondent would concededly be inequitable and work a hardship upon taxpayers, as the Court below specifically pointed out in its opinion herein. The construction advanced by the petitioner is fair and cannot under any circumstance work a hardship on the government.

ARGUMENT

WHERE DEPRECIATION IN EXCESS OF THAT ALLOWABLE IS REPORTED ON A RETURN FOR A LOSS YEAR AND DOES NOT OFFSET TAXABLE INCOME THE EXCESS IS NOT SUBTRACTED FROM COST IN DETERMINING THE ADJUSTED BASIS OF THE PROPERTY IN QUESTION.

The Revenue Act of 1938, Section 23 (l) provides for a deduction of a reasonable allowance for exhaustion, wear and tear of property used in business. Section 23 (n) provides that the basis upon which exhaustion, wear and tear are to be allowed shall be as provided in Section 114, which in turn provides that the basis is to be adjusted on account of depeciation in accordance with the provision of subsection (B) of Section 113(b)(1) as follows:

> "(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *"

The sole issue in this case is whether or not depreciation in the amount of $31,400.25 reported on petitioner's returns in its loss years from 1931 to 1936 which was in excess of that "allowable" for such years *and* which did not reduce taxable income was "allowed" within the meaning of the subsection quoted above. The decision of this case turns upon the meaning of the word "allowed" in that subsection.

Respondent contends that depreciation is "allowed" within the meaning of the statute quoted, if it is reported by a taxpayer on his return and not objected to by the Commissioner, even though it admittedly exceeds the amount "allowable" and also does not reduce taxable income. Petitioner contends, on the contrary, that such excessive depreciation is "allowed" within the meaning of

the statute only if it offsets taxable income and thus reduces the taxes which otherwise would have been payable.[3]

1. Distinction between the words "allowed" and "allowable" in Section 113(b)(1)(B).

Experience before the Court below and before the Bureau of Internal Revenue suggests that before entering into an analysis of the meaning of the word "allowed" there should be brought clearly into focus two vital facts which must be kept fully in mind.

First, petitioner has conceded throughout, and there is no issue whatsoever in this case on the proposition, that the depreciation properly "allowable" in any year is a deduction for that year and reduces the basis of the property, whether or not the taxpayer had income in that year—a point which has been long since decided. *U. S.* v. *Ludey,* 274 U. S. 295; *Hardwick Realty Co.* v. *Commissioner,* 29 F. (2d) 498 (C. C. A. 2d); *Beckridge Corp.* v. *Commissioner,* 129 F. (2d) 318 (C. C. A. 2d). The sole issue here is with reference only to that portion of depreciation reported on a return in a loss year *which exceeds the amount of depreciation properly "allowable"*.

---

[3] Although the meaning of the word "allowed" is the sole issue involved, the Circuit Court of Appeals states in the second sentence of its opinion (R. 46):

> "The question involved relates to the right of a taxpayer to add to the depreciation base, on a change of the rate of depreciation, amounts charged off *and allowed* as depreciation in prior years, where no tax benefit has been received as result of such allowance." (Emphasis supplied.)

The Court below could not reasonably have been expected correctly to analyze the problem when it began the opinion with the *assumption* that the excessive depreciation which did not reduce taxable income *was "allowed"*. That is the sole issue to be determined. If the excess depreciation was "allowed" within the meaning of the subsection, as the Court below *assumed,* of course it reduces basis.

Second, the statute uses the words "allowed" and "allowable" in clear contrast to each other; and a full appreciation of the vital distinction between the respective meanings of these words is essential to any understanding of the issue involved. Obvious as the distinction may seem, it has been constantly ignored.

The word "allowable" in the subsection quoted refers to the depreciation which the taxpayer is legally entitled to deduct in any year. The taxpayer has no more option as to whether and when such depreciation must be deducted than he has with reference to any other deduction accruing in a particular year. There is a wasting of the property to that extent in the particular year and it must be deducted just as would be true of rent or interest or a loss on a sale or any deduction accruing in a particular year. It is immaterial that it may not reduce taxable income nor result in any tax advantage. The requirement that "allowable" depreciation, like all other expenses actually accruing in any year, be taken in the year in which it occurs, regardless of whether there is any income against which it may apply, is inherent in the theory of the computation of income and taxes upon an annual basis (*Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301). The taxpayer is clearly required to deduct the "allowable" depreciation for each and every year in adjusting the basis of property for computing gain or loss on sale or for computing depreciation for subsequent years. It is and has always been admitted by petitioner that the 5% depreciation "allowable" for each of the years 1931 to 1936 inclusive must be deducted from basis whether or not it reduced taxable income one iota or saved petitioner one penny of tax. Petitioner has never suggested otherwise.

Now as to the word "allowed" as used in Section 113(b)(1)(B). *In those cases where it is applicable* the word "allowed" as there used clearly has the effect of

requiring a reduction of basis by an amount of depreciation which is in excess of the depreciation legally and properly deductible. Otherwise the word "allowed" would be pure surplusage. The word "allowable" standing alone is entirely ample to require the reduction of the basis by the full amount of the depreciation properly deductible. It is clear therefore that the word "allowed" was inserted to require *in some instances* the reduction of basis on account of depreciation which has been deducted improperly and without legal authority in prior years.

2. Legislative History of Section 113(b)(1)(B).

An examination of the legislative history of Section 113(b)(1)(B)[4] makes it clear that *the particular instances* in which Congress wished to bind a taxpayer because of improper and excessive deductions of depreciation in prior years were where such excessive and improper deductions resulted in reducing taxable income in prior years and the statute of limitations prevents recovery of the taxes justly due for such prior years.

Prior to the Revenue Act of 1924 there was no specific provision with respect to adjustment for depreciation in computing gain or loss from a sale of property. In spite of this fact the courts held that when property is sold the basis thereof must be reduced by the aggregate amount of depreciation which was legally "allowable" in prior years.

---

[4] The well settled principle that explanatory legislative history will be considered in construing a statute needs no citation of authority. It seems appropriate, however, to refer to the following recent statement of Mr. Justice Murphy speaking for the court in the case of *Harrison* v. *Northern Trust Co.*, 317 U. S. 476, 479:

> "But words are inexact tools at best, and for that reason there is wisely no rule of law forbidding resort to explanatory legislative history no matter how 'clear the words may appear on "superficial examination"' ".

See *United States* v. *Ludey*,[5] *supra; Hardwick Realty Co.* v. *Commissioner, supra.*

Section 202 (b) of the Revenue Act of 1924 (43 Stat. 253) provided that in computing gain or loss, adjustments should be made for depreciation "previously allowed." The word "allowed" as used in this section of the 1924 Act seems never to have been judicially construed. It does appear from the report of the Senate Finance Committee (Sen. Rep. 398, p. 13; 6th Cong., 1st Sess.) that the words "properly chargeable" were incorporated originally in the House Bill. The only reason stated for the substitution of the words "previously allowed" by the Senate for the words "properly chargeable" is "to remove a possible ambiguity in the House Bill".

Section 202 (b) of the Revenue Act of 1926 (44 Stat. 9) and Section 111(b)(2) of the Revenue Act of 1928 (45 Stat. 791) provided for adjusting basis by deduction of the depreciation which, since the acquisition of the property, had been "allowable" in respect of such property; and made no provision for the deduction of depreciation "allowed." The Senate Finance Committee Report on the 1926 Act (Sen. Rep. 52, p. 15, 69th Cong., 1st Sess.) indicated that the purpose of changing from the words "previously allowed" used in the Revenue Act of 1924 was to prevent a taxpayer from electing to take no depreciation "against his annual income" and writing off his entire cost at the time of sale.

In the years between 1926 and 1932, however, it became evident that the section as drawn was unsatisfactory, be-

---

[5] In *United States* v. *Ludey,* Mr. Justice Brandeis said (274 U. S. at p. 304):

> "On the other hand, we cannot accept the Government's contention that the full amount of depreciation and depletion sustained, whether allowable by law as a deduction from gross income in past years or not, must be deducted from cost in ascertaining gain or loss. Congress doubtless intended that the deduction to be made from the original cost should be the aggregate amount *which the taxpayer was entitled to deduct* in the several years." (Emphasis supplied.)

cause some taxpayers who had obtained the benefit in prior years of deductions against income for depreciation in excess of the amount "allowable" were, upon sale, insisting upon adjusting the cost basis of their property only to the extent of the "allowable" depreciation and were thus seeking to obtain a double deduction to the extent of the difference between the "allowable" depreciation and the excessive depreciation deducted from income in prior years. It was this situation which Congress recognized as requiring its attention when it drafted the Revenue Act of 1932 (47 Stat. 169). Without in any way changing the requirement for the deduction in each year of the amount of depreciation "allowable" in such year, Congress provided, in Section 113(b)(1)(B) of the Revenue Act of 1932, against a taxpayer claiming a double deduction by requiring that basis should be adjusted for depreciation—

> "to the extent allowed (but not less than the amount allowable)".

The provisions of this section have been incorporated without change, as Section 113(b)(1)(B), in all subsequent Revenue Acts. The Senate and the House committees, in substantially identical language, explained the reason for the change. The Senate Finance Committee Report (Sen. Rep. 665, p. 29, 72nd Cong., 1st Sess.) contains the following statement:

> "In subparagraph (B), [of Sec. 113(b)(1)], relating to depreciation, etc., for the period since February 28, 1913, the bill requires that adjustment be made to the extent allowed (but not less than the amount allowable) instead of 'by the amount * * * allowable' as in the prior act. The Treasury has frequently encountered cases where a taxpayer, who has taken and been allowed depreciation deductions at a certain rate consistently over a period of years, later finds it to his advantage to claim that the allowances so made to him were excessive and that the amounts which were in fact 'allowable' were much less. By this time the government may be barred from collecting the additional taxes which would be due for the prior years upon the strength of the taxpayer's

present contentions. The Treasury is obliged to rely very largely upon the good faith and judgment of the taxpayer in the determination of the allowances for depreciation, since these are primarily matters of judgment and are governed by facts particularly within the knowledge of the taxpayer and the Treasury should not be penalized for having approved the taxpayer's deductions. While the Committee does not regard the existing law as countenancing any such inequitable results, it believes the new bill should specifically preclude any such possibility.'"[6]

A consideration of this statement of the Committees makes it clear that the sole purpose of Congress in adding

---

[6] The quoted portion above is identical in the Senate and House Reports. The Senate Report, however, contains two additional sentences, which do not appear in the earlier House Report, as follows:

> "Your committee has not thought it necessary to include any express provision against retroactive adjustments of depreciation on the part of the Treasury as the regulations of the Treasury seem adequate to protect the interests of taxpayers in such cases. These regulations require the depreciation allowances to be made from year to year in accordance with the then known facts and do not permit a retroactive change in these allowances by reason of the facts developed or ascertained after the years for which such allowances are made."

The Court below apparently considered the foregoing sentences as indicating Congressional intention that respondent's construction of Section 113(b)(1)(B) be accepted. As a matter of fact, those sentences do not relate to the amendment which Congress was then enacting. Those sentences relate to other suggestions which the Committee had apparently considered—suggestions for other possible amendments to the Section *to prevent the Commissioner from treating the taxpayer unfairly* by retroactive changes of position. They certainly do not indicate that the amendment which Congress was enacting to prevent the taxpayer from obtaining the inequitable advantage of a double deduction should be used to bind him to an error from which he has obtained no advantage of any sort and from which the Treasury has suffered no loss.

the requirement that depreciation "allowed" as well as that "allowable", be deducted was to require the deduction of excessive and improperly deducted depreciation where-ever the deduction has resulted in reducing taxable income in the earlier year *and* the Commissioner is barred from recovering the taxes justly due in the earlier years. The statement refers to the fact that the Treasury has frequently encountered cases where a taxpayer seeks to obtain the benefit of a double deduction by contending that the depreciation "taken and allowed" in prior years was not actually deductible. It states that it does not want the Treasury *penalized* by such a change of position. All these statements can have reference only to a situation where just taxes have been avoided. They would be meaningless in a case where no taxes have been avoided.

The Circuit Court of Appeals for the Third Circuit in *Pittsburgh Brewing Co.* v. *Commissioner*, 107 F. (2d) 155, reviewing the legislative history, makes the following statement (at p. 156):

> "Obviously the Committee referred to the situation in which a taxpayer, having had the benefit of a larger depreciation deduction from gross income than was properly allowable to him, claims upon the sale of the depreciated property that his sale basis should be increased by deducting only the smaller depreciation properly allowable, thus gaining a double deduction against taxable income. We think it clear that it was to prevent the possibility of such a double deduction that the provisions of the Revenue Act of 1932 which we are considering were enacted. No double benefit can be received where, as in the case before us, the depreciation originally claimed offset no income which would otherwise have been taxable."

The last sentence in the quotation from the Senate Report set forth in the text, supra (pp. 13-14), is especially significant. It says:

> "*While the Committee does not regard the existing law as countenancing any such inequitable results*, it believes the new bill should specifically preclude any such possibility." (Emphasis supplied.)

The Committee in the italicized portion of the sentence is referring to the situation existing under the 1928 Act which provided for the deduction from basis of only depreciation "allowable" in prior years and made no provision for any adjustment for depreciation in excess of that allowable which had been reported by a taxpayer on its returns. If *under the 1928 Act* the Treasury could be protected against "any such inequitable result", it was only by preventing, upon some principle analogous to estoppel, the correction of the prior error. *Damage* of course would be an essential element, and damage could exist only where there was some avoidance of tax, and there could be no avoidance of tax where no tax was due. Therefore under the 1928 Act the Treasury clearly could not have bound the taxpayer in a situation like the present on account of its error in reporting excessive depreciation on its returns for prior years. That being true, and since the amendment in 1932 was intended to give the Treasury *statutory* protection in only those situations where the Committees felt that *equity* already may have afforded protection, the statute obviously was not intended to apply in a situation like the present where every equity is with the taxpayer and against the Treasury.

3. Ordinary meaning of the word "allowed".

If, in order to give the subsection the effect clearly intended by Congress, as shown by the reports of both Congressional Committees, it were necessary to give to the word "allowed" a strained and unnatural meaning, the interpretation of the subsection would present difficulty. But quite the contrary is true. The usual and ordinary meaning of the word, "allowed," fits clearly into the Congressional purpose. The word "allowed" in ordinary usage means "To grant (something) as a deduction or an addition; esp. to abate or deduct; as, to allow a sum for leakage." (Webster's International Dictionary, 2nd Ed.). After referring to the foregoing definition, the Circuit Court of Appeals for the Third Circuit in *Pittsburgh*

Brewing Co. v. *Commissioner*, supra, quite correctly concluded that the word " 'allowed' in the statute accordingly means granted as a deduction." And that court correctly, as we think, took the view that if, after there are deducted from the correct gross income only the proper and legal deductions leaving no income against which a deduction of improper and excessive depreciation may be taken, such excessive depreciation is not "allowed" as a deduction. How was the deduction "allowed" when there was nothing against which it could be "allowed" and where there was not even any reason for considering whether it should be allowed?

4. General attitude of Congress and Commissioner toward erroneous deductions.

The correctness of petitioner's construction of the subsection is confirmed by another consideration of the utmost importance. No case will be found—unless the present be such a case—where Congress has ever sought to bind a taxpayer for the future by reason of past erroneous and unauthorized treatment of items of income or deductions, *unless* a change of position will result in depriving the government of taxes to which it is justly entitled. Such a situation can arise only if the error in the earlier year resulted in reducing the taxes which would otherwise have been payable in that year *and* the statute of limitations has barred the correction of the error. We know of no single situation other than this depreciation situation where the Commissioner has attempted to bind the taxpayer by past errors, except where it is necessary to prevent an injustice to the public revenue, a situation which can arise only if taxes have been avoided in the earlier year and the statute of limitations has run. The Commissioner's position here is based not upon any claim of equity but solely upon his alleged interpretation of the word "allowed." It has been the universal practice of the Commissioner not to perpetuate errors of income or deduction nor to carry forward into other years

the effect of such errors *unless* to do so will deprive the government of taxes to which it is justly entitled.

One very simple example—an example closely analogous to the depreciation situation—will serve to show how errors in past years are generally treated: Suppose a taxpayer buys a 10 acre tract of land for $10,000.00. He sells 5 acres for $10,000.00 and in figuring the profit on the sale attributes $7,500.00 of the cost to the 10 acres sold. On a later sale of the other 5 acres for $10,000.00 he seeks to attribute $5,000.00 of the cost to the latter 5 acres, which we shall assume is a correct division of the cost. *If* a reduction of the taxes which otherwise would have been due resulted from the use of the erroneous division of cost on the sale of the first 5 acres *and if* the statute of limitations had barred the correction of the error in the earlier year, the Commissioner might attempt on some theory of estoppel or *quasi*-estoppel to bar the taxpayer from using a cost of more than $2,500.00 on the second 5 acres. If, on the other hand, the statute of limitations had not run or if no tax benefit resulted from the erroneous treatment of the sale of the first 5 acres, the Commissioner undoubtedly would not even suggest—and certainly no court would think of holding—that the error in the earlier year would prevent the correct computation of income in the later year.

The deduction for depreciation is quite similar to a sale of property fractionally each year. If the taxpayer treats as wasting in any one year a greater fraction of cost than is proper, the only reason that would justify an attempt by the government to perpetuate rather than to correct the error would be that the correction of the error of the earlier year would result in additional taxes which cannot now be collected because barred. Where no taxes would be due in the earlier year if the error were corrected or where the collection of such taxes as would result is not barred, there can be no reason whatever for deducting from basis an amount of depreciation greater than that legally "allowable" in the earlier year. A holding to the contrary would place erroneous and improper deductions of depreciation in a different situation from all other erroneous deductions.

There is no sound basis for respondent's refusal to correct this error under circumstances under which all other errors would be corrected.

It is significant that, when in 1938 the Treasury came to propose to Congress general provisions to protect the Government and taxpayers against changes in position by the other party, it did not recommend that Congress bind the party to an erroneous position taken in a prior year even where such error had affected tax liability in such prior year. The Treasury suggested on the contrary that where a position inconsistent with a prior erroneous position is successfully maintained in a later year the statute of limitations shall be opened up for the collection or refund for such prior year of whatever tax results from correcting the error. This is the basis of the relief provisions adopted by Congress in Sections 3801 and 734 of the Internal Revenue Code. The Senate Committee in reporting out Section 3801, which first came into the law as Section 820 of the Revenue Act of 1938 (the very act here under consideration) expressly stated (Sen. Rep. No. 1567, pp. 48-50, 75th Cong. 3rd Sess.), that one of the principles upon which the legislation proceeded was that:

> "Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer, and of establishing the proper basis."

And yet the Commissioner in the present case insists upon establishing an erroneous basis by the perpetuation of an error which had no tax effect in the prior year and the perpetuation of which is not required by any considerations of justice.

5. Legislative approval of Petitioner's Construction of Section 113(b)(1)(B).

There is an additional circumstance in the recent legislative history of Section 113(b)(1)(B) which seems to us to show that Congress intended the construction advanced by petitioner. That subsection, as enacted in 1932, is now in-

cluded without any material change as Section 113(b)(1)(B) of the Internal Revenue Code. In October of 1942, when the Revenue Act of 1942 was enacted, the issue involved herein as to the proper construction of the word "allowed" in that subsection was squarely involved in four reported cases, namely, *Pittsburgh Brewing Co.* v. *Commissioner*, supra, *Kennedy Laundry Co.*, 46 B. T. A. 70, *Don Lee, Inc.* v. *U. S.*, 42 F. Supp. 884 (N. D. Cal.); and the Board's decision in the case at bar.[7] Every one of these cases had construed the meaning of the word "allowed" in accordance with the construction advanced by petitioner herein and no case had been decided in favor of the construction advanced by respondent. The *Pittsburgh Brewing Co.* case, supra, had been decided as long ago as 1939. With this judicial record before it Congress did not change one word of subsection (B) of Section 113(b)(1) although it amended Section 113(b)(1) in a number of respects. This certainly suggests, to say the least, that the uniform construction of the word "allowed" by the Board of Tax Appeals and the Courts met with Congressional approval. It was not until the Fourth Circuit handed down its decision in this case in January, 1943, months after the enactment of the Revenue Act of 1942, that any case was decided supporting the construction advanced by respondent.

6. Unfairness of Section 113(b)(1)(B) as Construed by Respondent.

The construction advanced by petitioner cannot in any way work unfairly against the government. It is to be noted,

---

[7] The *Kennedy Laundry Co.* decision of the Board has since been reversed by the Circuit Court of Appeals for the Seventh Circuit (133 Fed. (2d) 660) and is now pending here on petition for writ of certiorari, No. 958. The decision of the District Court in the *Don Lee* case is pending on appeal in the Circuit Court of Appeals for the Ninth Circuit. On November 3, 1942, the District Court for the District of Utah, in the case of *Gunnison Sugar Co.* v. *Hinckley*, 1942 C. C. H. § 9812, rendered another decision in favor of petitioner's position.

however, that the Circuit Court for the Fourth Circuit in deciding the present case against the taxpayer recognized the unfairness of the result to the taxpayer. The Court said (R. 52):

> "The method used by Commissioner for computing depreciation through the remaining years of useful life of the property seems to involve hardship in view of the fact that the taxpayer has received but little tax benefit for the depreciation allowed, and the rates for the remainder of the useful life are less than they would have been if the rates and useful life had been correctly computed in the first instance."

The recognition of the injustice which results from the Court's construction should be persuasive that Congress must have intended the opposite construction. In the absence of language clear enough to compel it, it is difficult to understand how the Court, in attempting to determine the intention of Congress, could arrive at the conclusion that Congress intended to accomplish a result which is contrary to all past practice and in no way suggested by the legislative history of the subsection and which is admittedly unfair.

Conclusion

Petitioner submits that the United States Circuit Court of Appeals for the Fourth Circuit was clearly in error in deciding that petitioner's depreciable assets as of December 31, 1937 must be reduced by $31,400.25, the amount of the excessive depreciation improperly reported on its returns in the years 1931 to 1936 inclusive, where such excessive depreciation did not reduce petitioner's taxable income. The judgment of the Court below should be reversed.

Respectfully submitted,

F. G. Davidson, Jr.,
Noah A. Stancliffe,
Theodore L. Harrison,
J. Donald Rawlings,
W. A. Sutherland,
Counsel for Petitioner.